Know Your Escrow Rights

The Lawyer's Edition

by Frederick Miller

Foreword

Since 1982, New York State's legal profession, through its Lawyers' Fund for Client Protection, has restored more than $75 million to law clients and beneficiaries of escrow transactions for money and property that was misused in the practice of law. Each year the Trustees of the fund budget $8 million to provide reimbursement to eligible victims of lawyer dishonesty.

Escrow losses coming to the Lawyers' Fund typically involve escrows in real property transactions, usually residential sales and down payments. Other escrow losses include bulk sales and special deposits created in the course of litigation.

Because the New York Lawyers' Fund provides clients with coverage of $200,000 per loss, most escrow thefts qualify for full reimbursement if, of course, the dishonest (and disbarred or dead) practitioner is unable to make restitution. In a typical year, losses are attributable to less than 50 dishonest lawyers. At the close of 1998, there were more than 177,000 licensed lawyers in the Empire State.

There's an old and solid principle of common law that law clients can rightfully trust in the integrity of their attorneys. That being said, no law client is excused from exercising common sense, or an informed judgment. In the field of escrow, clients (and lawyers) have practical means to prevent losses and, in some cases, to promptly detect and remedy them.

Toward those ends, the Trustees of the Lawyers' Fund have published a pamphlet called, *Know Your Escrow Rights*. It's a plain-English guide to the rights of consumers and law clients, and the fiduciary obligations of escrow agents. It's available from the Lawyers' Fund without charge.

The practical suggestions in *Know Your Escrow Rights* are based upon New York laws, rules and court decisions. Observing them will help consumers avoid disagreements in escrow transactions, and prevent the misuse or loss of escrow money and property. For the Lawyers' Fund, every dollar saved from loss is a dollar that will be used to help other law clients in need of reimbursement.

What follows is the plain-English text of the consumer pamphlet, annotated as a public service for members of the New York bar. The preface to the consumer edition includes the important admonition:

Because escrow agreements are legal contracts that involve important rights and obligations, the careful consumer will consult an attorney before entrusting money or property with an escrow agent.

What's an escrow?

An escrow is a legal arrangement to help parties perform their contracts and avoid disagreements. The escrow agreement has three parties: a "depositor", an "escrow agent" and a "beneficiary".[1]

In the typical escrow, the depositor is required to entrust money or property with an escrow agent. The escrow agent holds the escrow deposit until it can be released to the beneficiary upon the happening of some future event, or the performance of some condition.[2]

A common example involves the down payment in the purchase and sale of a residence, condominium or cooperative. The contract frequently requires that the buyer's down payment be paid to the seller's lawyer, in escrow, or to a real estate broker, pending the title closing.[3]

In this escrow example, the buyer is the depositor, and the seller is the beneficiary. The seller's lawyer or real estate broker is the escrow agent who undertakes to safeguard the down payment in a special bank account until the contract has been performed, or is canceled by the buyer and seller.[4]

If the purchase goes forward as planned, the escrow agent will release the down payment to the seller at the title closing. If the buyer and seller agree to cancel their contract, the escrow agent is usually required to return the down payment to the buyer.

The escrow will terminate when the contract has been performed;[5] abandoned;[6] or the escrow fund depleted.[7]

What are other examples of escrows?

Other escrows include settlements in personal injury and other court cases; agreements to distribute property in matrimonial actions; and, in the bulk sale of business assets, escrows to insure that taxes and business debts will be paid.

There are also consumer escrows that are regulated by special state laws. Examples include escrow accounts for rent security deposits;[8] real property tax escrow accounts required by mortgage lenders;[9] deposits paid to builders constructing new homes;[10] down payments for homeowners associations and time-share projects;[11] advance fees paid to automobile brokers;[12] membership fees paid to health clubs and licensed campgrounds;[13] and entrance fees and deposits paid on life-care community contracts.[14]

Are written escrow agreements required?

Not in all cases. However, someone considering an escrow transaction should insist that the escrow agreement be in writing, and be reviewed by a lawyer. Every escrow agreement should contain provisions which set forth:

- the names and addresses of the depositor, the escrow agent and the beneficiary;
- the amount of the escrow deposit;

The Lawyers' Fund for Client Protection
of the State of New York

- the name and address of the bank where escrow money will be deposited, and the title and number of the bank account;
- whether the escrow agent is required to use an interest-bearing account, and how the interest earned on the deposit will be distributed;
- the conditions that must occur or be performed before the escrow agent can release the escrow fund;
- time limits for the performance of these conditions;
- the names and addresses of all persons who will be paid the escrow fund; and
- the duties of the escrow agent in the event the conditions of the escrow agreement cannot be met.[15]

It's also a good practice for the parties, or their attorneys, to require a copy of the written agreement, and a periodic status report from the escrow agent regarding the current balance in the escrow account, if any, and its location.

Who does an escrow agent work for?

The escrow agent's authority is defined and controlled by the escrow agreement.[16] It is beyond an escrow agent's authority to amend or reform an inadequate or ambiguous escrow agreement.[17]

A person who serves as an escrow agent is a fiduciary, with duties to all parties who have an interest in the escrow property.[18] The most important duty is to safeguard the escrow property.[19] If it's money, it must be deposited in a special bank account that's separate from the escrow agent's personal and business accounts.[20]

An escrow agent should provide the parties with a receipt for the escrow property, a copy of the escrow agreement and keep complete and accurate records.[21] Depositors and beneficiaries have a right to a full accounting of the escrow agent's management of the escrow property.[22]

An escrow agent has the legal duty to comply strictly with the terms and conditions of the escrow agreement.[23] Escrow property cannot be delivered to anyone, except in accordance with the provisions of the escrow agreement.[24]

An escrow agent who releases escrow property in violation of an escrow agreement is subject to money damages in a civil court action brought by any party who has suffered economic loss because of the agent's breach of duty.[25]

A law firm commits a conversion when it withdraws a legal fee from a settlement escrow and prejudices the superior rights of an escrow beneficiary.[26]

Are escrow agents paid for their services?

Escrow agents can serve with or without compensation. If an escrow agent expects to be paid for administering an escrow account or property, the matter of fees and reimbursement of expenses should be clearly set forth in the escrow agreement.

Can escrow agents assert liens against escrow property?

No. An escrow agent can have no claim or lien on the escrow deposit for services rendered,[27] unless the escrow agreement provides otherwise.[28]

The escrow agent is simply a custodian of the escrow property,[29] which must be paid out as the escrow agreement provides.[30]

Are interest-bearing accounts required for escrow deposits?

Not in all cases,[31] but escrow agreements should require interest-bearing accounts when escrow funds can generate significant interest for one or more of the parties. For small and short-term escrow deposits, lawyers are permitted by state law to use so-called "IOLA" bank accounts".[32] Interest earned on these IOLA accounts is pooled and used to finance civil legal services for the poor.[33]

If you arrange for an interest-bearing bank account, the escrow agent and bank may require a Social Security or Federal Tax Identification number for federal and state income tax purposes.

Can escrow agents keep bank interest?

No. All interest that's earned on an escrow deposit should be paid out in accordance with the escrow agreement, or to the party whose money generated the interest. It would be a conflict of interest for an escrow agent, as a fiduciary,[34] to require that bank interest be treated as compensation for services rendered.[35]

If an escrow deposit is stolen, who bears the loss?

Unless an escrow agreement provides otherwise, the loss generally falls on the party who owned the escrow property at the time of its theft.[36] In the case of a stolen down payment, that's usually the buyer, who may be asked by the seller to replace the down payment before title closes. Of course, an injured party will have the right to seek money damages from the dishonest escrow agent.[37]

Are there danger signals to watch for?

Yes, and consumers can protect themselves against losses. A deposit of money with an escrow agent should be made by check, for example, and not with cash. The check should be promptly deposited in a special bank account identified in the escrow agreement. The depositor should review the endorsement on the check to make sure that the escrow agent has made the proper bank deposit. The beneficiary of an escrow agreement should be wary if an escrow agent delays in releasing escrow property. And a bounced check from an escrow agent is a signal that escrow money might have been misused. In these situations, the careful consumer will promptly consult a lawyer.

How to handle disputes.

The escrow agent must make an independent determination whether the parties have complied with the escrow agreement.[38] A party who claims a right to an escrow deposit must show a clear right to the deposit.[39] An escrow agent who is uncertain as to which claimant is entitled to possession of the escrow deposit, or whether the agreed condition in the escrow agreement has been performed, has the remedy of interpleader, [40] in which the escrow agent deposits the escrow with a court and seeks a judicial determination as to its rightful owner.[41]

What's the Lawyers' Fund for Client Protection?

The New York Lawyers' Fund is a state agency that the legal profession finances to

The Lawyers' Fund for Client Protection
of the State of New York

protect law clients from dishonest conduct in the practice of law.[42]

The Lawyers' Fund is administered by a Board of Trustees composed of lawyers and non-lawyers.[43] The Trustees are permitted to reimburse law clients when a lawyer misuses or steals client money and property in the practice of law.[44]

The fund's coverage is $200,000 per client loss.[45] To qualify, the loss must occur in the practice of law, and an attorney-client relationship.[46]

Reimbursement procedures are simple and cost-free. In addition, lawyers who help clients seek reimbursement cannot charge legal fees for this professional service.[47]

Losses reimbursed by the fund include the theft of down payments in real property transactions, estate and trust assets, personal injury settlements and money embezzled from clients in investment transactions. The fund cannot settle fee disputes, or compensate for a lawyer's malpractice or neglect.[48]

A law client seeking reimbursement must also file a complaint with the appropriate Attorney Grievance (Disciplinary) Committee in the locality where the lawyer practices, and cooperate fully with the Committee's investigation.[49] Awards from the fund are generally made after a lawyer's disbarment, and where the lawyer is unable to make restitution.

Application forms, information and other help is available from the offices of the New York Lawyers' Fund in Albany. Telephone 518-434-1935 or 800-442-FUND (3863). Internet: www.nylawfund.org

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The Trustees of the New York Lawyers' Fund

Section 468-b of the Judiciary Law provides for the administration of the fund; and section 97-t of the State Finance Law governs the management of its assets as a special trust account on deposit in the State Treasury. Both statutes vest management authority in the fund's Board of Trustees.

They serve renewable terms of three years, and without compensation for their services. Since 1981, the Court of Appeals has preserved the mix of five members of the bar and two business and community leaders.

The Board's officers are a Chairman, Vice-chairman, and Treasurer. The fund's Executive Director serves as the Board's Secretary and its Counsel.

Statutes and judicial precedent give the Board sole discretion to determine the merits of claims, and the amount of reimbursement to be awarded.

Distinguished former members of the Board of Trustees include Chief Judge Judith S. Kaye (1981-1983); Joseph Kelner, Esq. (1981-1982); Anthony R. Palermo, Esq. (1981-1990); and John F.X. Mannion (1981-1992).

Eleanor Breitel Alter of Manhattan has served as Chairman of the Board of Trustees since 1985. She is a partner in the Manhattan law firm of Kasowitz, Benson, Torres & Friedman.

Theodore D. Hoffmann of Hicksville, Nassau County, is Vice-Chairman of the Board. Mr. Hoffmann is Counsel to the Garden City law firm of Albanese, Albanese & Fiore.

Ray W. Manuszewski of Cheektowaga, Erie County, is the fund's Treasurer. A graduate of Canisius College (1951), Mr. Manuszewski is a former Regional President of Manufacturers Hanover Trust Company N.A. in Buffalo.

Bernard F. Ashe of Delmar, Albany County, is a former General Counsel to New York State United Teachers.

Charles Joseph Hynes of Brooklyn is the District Attorney of Kings County.

Eric A. Seiff lives in the Bronx and is a partner in the Manhattan law firm of Seiff Kretz & Maffeo.

Shirley B. Waters of Rome, Oneida County, is Vice President of the Rome Sentinel Company, which publishes the *Daily Sentinel* newspaper.

Annotations

[1] *Silberstein v. Murdoch*, 216 App. Div. 665, 216 N.Y.S. 657 (1st Dep't 1926).

[2] 55 N.Y. Jur.2d Escrow § 1; *see, Animalfeeds Internat'l, Inc. v. Banco Espirito Santo E Commercial De Lisboa*, 101 Misc. 2d 379, 420 N.Y.S.2d 954 (New York Co. Sup. Ct. 1979); *National Union Fire Ins. Co. v. Proskauer Rose, N.Y.L.J., August 16, 1994, at 22 (New York Co. Sup. Ct.).*

[3] *See, N.Y. Gen. Bus. Law §§ 778, 778-a.*

[4] *New York Lawyer's Code of Professional Responsibility DR 9-102(A); 22 NYCRR 1200.46(a); see generally, Assoc. Bar, NYC, Comm. on Prof. & Jud. Ethics, Op. 86-5 (1986); Assoc. Bar, NYC, Comm. on Prof. Disc., Other People's Money: Procedures and Pitfalls in Handling Client Funds; New York Lawyers' Fund for Client Protection, A Practical Guide to Attorney Trust Accounts and Recordkeeping (1992).*

[5] 55 N.Y. Jur. 2d Escrow § 1; *see* Id.; *National Union Fire Ins. Co. V. Proskauer Rose*, N.Y.L.J., August 16, 1994, at 22 (New York Co. Sup. Ct.).

[6] *Kosiniski v. Gallt* 58 Misc. 2d 124, 294 N.Y.S.2d 602 (Nassau Co. Sup. Ct. 1968).

[7] *Re Estate of Reece* 122 Misc.2d 517, 470 N.Y.S.2d 974 (1983)

[8] *N.Y. Gen. Oblig. Law § 7-103 (McKinney's 1989).*

[9] *N.Y. Gen. Oblig. Law §§ 5-601 et seq. (McKinney's 1989).*

[10] *N.Y. Gen. Bus. Law §§ 779 et seq. (McKinney's 1984).*

[11] *N.Y. Gen. Bus. Law § 352-e(2)(b) (McKinney's 1984 & Supp. 1994).*

[12] *N.Y. Gen. Bus. Law §§ 740 et seq. (McKinney's 1984 & Supp. 1994).*

[13] *N .Y. Gen. Bus. Law §§ 687 et seq. (McKinney's 1984 & Supp. 1994).*

[14] *N.Y. Pub. Health Law § 4611 (McKinney's 1985 & Supp. 1994).*

[15] *See, Animalfeeds*, 101 Misc. 2d at 383, 420 N.Y.S.2d at 957; for drafting considerations, *see* 8 Am. Jur. Legal Forms 2d §§ 100.11 et seq.; 19 West Legal Forms 2d §§ 13.1 et seq.

[16] 55 N.Y. Jur.2d Escrow §15; *see Gershen v. Gershen* 6 A.D.2d 862, 175 N.Y.S.2d 841 (1st Dep't 1958); *Entertainment & Amusements of Ohio, Inc. v. Barnes* 49 Misc. 2d 316, 267 N.Y.S.2d 359 (Onondaga Co. Sup Ct. 1966).

[17] *N.Y.S. Comm. On Professional Ethics, Op. 710 (1998); see* 22 N.Y. Jur.2d Escrow § 15; *see also, Stein v. Rand Constr. Co.* 400 F. Supp 944, 16 UCCRS 1150 (S.D.N.Y. 1975)

[18] *Oppenheim v. Simon*, 57 A.D.2d 1006, 394 N.Y.S.2d 500 (3d Dep't 1977); *see, Assoc. Bar, NYC, Comm. on Prof. & Jud. Ethics, Op. 86-5 § 1 (1986).*

[19] *Matter of Neuhoff's Will*, 107 Misc. 2d 589, 435 N.Y.S.2d 632 (Nassau Co. Surr. Ct. 1980), *aff'd* 107 A.D.2d 417, 486 N.Y.S.2d 956 (2d Dep't 1985).

[20] *See, New York Lawyer's Code of Professional Responsibility DR 9-102(A); 22 NYCRR 1200.46(a).*

[21] *See, New York Lawyer's Code of Professional Responsibility DR 9-102(B)(3); 22 NYCRR. 1200.46(b)(3).*

[22] *See, New York Lawyer's Code of Professional Responsibility DR 9-102(B)(3); 22 NYCRR 1220.46(b)(3); Assoc. Bar, NYC, Comm. on Prof. & Jud. Ethics, Op. 86-5 § 10 (1986).*

[23] *Farago v. Burke*, 262 N.Y. 229, 186 N.E. at 685 (1933); *see, Matter of Bigman*, 178 A.D.2d 90 (2d Dep't 1992); *National Union Fire Ins. Co.*, supra note 2, at 22.

[24] *Farago*, 262 N.Y. at 133, 186 N.E. at 685

[25] *Grinblat v. Taubenblat*, 107 A.D.2d 735, 484 N.Y.S.2d 96 (2d Dep't 1985); *see National Union Fire Ins. Co.*, supra note 2, at 22; *see also Takayama v. Schaefer* 240 A.D.2d 21, 669 N.Y.S.2d 656 (2nd Dep't 1998).

[26] *See Bank of India v. Weg and Myers*, 1999 N.Y. App. Div. LEXIS 6487 (1st Dep't June 8, 1999)

[27] *Entertainment & Amusements of Ohio, Inc. v. Barnes*, 49 Misc. 2d 316, 267 N.Y.S.2d 359 (Onondaga Co. Sup. Ct. 1966); *National Union Fire Ins. Co.*, supra note 2, at 22; *see, Nassau Bar Opinion 85-7 (1985). See also Gala Enters. v. Hewlett Packard Co.*, 970 F. Supp. 212, (D.N.Y. 1997) (an escrow fund may be subject to attachment if the depositor retains sufficient control or interest over the funds); *Lang v. State* No. 1528-1528A, 1999 N.Y. App. Div. LEXIS 8929 (1st Dep't 9/2/99) (defendant's attorney could not assert a claim for legal fees against an escrowed restitution fund); *Koroleski v. Badler*, 32 A.D.2d 810, 303 N.Y.S.2d 221 (2nd Dep't 1969).

[28] *Entertainment & Amusements of Ohio, Inc. v. Barnes*, 49 Misc. 2d 316, 267 N.Y.S.2d 359 (Onondaga Co. Sup. Ct. 1966); *See, Heyward v. Maynard*, 119 App. Div. 66, 103 N.Y.S. 1028 (where attorney was entitled to be paid out of escrowed property because the parties had agreed to it).; *see also Mayeri Corp v. Shea and Gould*, 112 Misc. 2d 734, 447 N.Y.S.2d 413 (N.Y. Co. Sup. Ct. 1982) (where law firm held escrow deposit as escrow agent in landlord-tenant dispute, not as attorney for parties, the firm was not entitled to claim charging or retaining liens).

[29] *Entertainment & Amusements*, 49 Misc.2d at 318-19, 267 N.Y.S.2d at 363.

[30] *Farago*, 262 N.Y. at 233, 186 N.E. at 685. *See Lang v. State* No. 1528-1528A, 1999 N.Y. App. Div. LEXIS 8929 (1st Dep't September 2, 1999) (defendant's attorney could not assert a claim for legal fees against an escrowed restitution fund). *See also Gala Enters. v. Hewlett Packard Co.*, 970 F. Supp. 212, (D.N.Y. 1997) (an escrow fund may be subject to attachment if the depositor retains sufficient control or interest over the funds); *Koroleski v. Badler*, 32 A.D.2d 810, 303 N.Y.S.2d 221 (2nd Dep't 1969).

[31] *See, Assoc. Bar, NYC, Comm. on Prof. & Jud. Ethics, Op. 86-5 § 8 (1986).*

[32] *N.Y. Jud. Law § 497 (McKinney's 1983 & Supp. 1994); N.Y. State Fin. Law § 97-v(4) (McKinney's 1989).*

[33] *N.Y. State Fin. Law § 97-v(3) (McKinney's 1989).*

[34] *See, generally, Matter of Neuhoff's Will*, 107 Misc.2d 589, 435 N.Y.S.2d 632 (Nassau Co. Surr. Ct. 1980), *aff'd* 107 A.D.2d 417, 486 N.Y.S.2d 956 (2d Dep't 1985).

[35] *NYSBA, Ops. 532 (1981), 582 (1987); but cf. Assoc. Bar, NYC, Op. 81-68 (1981).*

[36] *Asher v. Herman*, 49 Misc.2d 475, 267 N.Y.S.2d 932 (Queens Co. Sup. Ct. 1966).

[37] *Grinblat*, 107 A.D.2d at 736, 484 N.Y.S.2d at 97.

[38] *Akivis v. Brecher* 128 Misc. 2d 965, 492 N.Y.S.2d 316 (Kings Co. Sup. Ct. 1985); *see* 55 NY Jur 2d Supp § Escrow 16.

[39] *Takayama v. Schaefer* 240 A.D.2d 21, 669 N.Y.S.2d 656 (2nd Dep't 1998); *see Falk v. Goodman* 7 N.Y.2d 87, 195 N.Y.S.2d 645; *see also Falk v. Goodman* 7 A.D.2d 1014, 185 N.Y.S.2d 231 (2nd Dep't 1959)

[40] *NY CPLR 1006 (McKinney's 1997); see* 55 N.Y. Jur.2d Escrow § 40.

[41] *Casolaro v. Blau* 4 Misc. 2d 206, 158 N.Y.S.2d 589 (Queens Co. Sup. Ct. 1956); *Lindley v. Robillard* 208 Misc. 532, 144 N.Y.S.2d 33 (Onondaga Co. Sup. Ct. 1955); *see* 55 N.Y. Jur.2d Escrow § 41.

[42] *22 NYCRR 7200.1.*

[43] *22 NYCRR 7200.2(a),(b).*

[44] *22 NYCRR 7200.4(g), 7200.8(a)(2).*

[45] *22 NYCRR 7200.13(a).*

[46] *22 NYCRR 7200.8(a)(1),(2).*

[47] *22 NYCRR 7200.14(b).*

[48] *22 NYCRR 7200.8(d),(e)(3).*

[49] *22 NYCRR 7200.8(a)(5).*